SUBSIDY/SUPPORT MECHANISMS

A. PURPOSE

The purpose of this paper is to identify and describe some of the interstate mechanisms that currently help subsidize or support the provision of universal service.

B. BACKGROUND

The present economics of local exchange telecommunications is one involving a number of subsidies and support mechanisms intended to achieve social benefits. These mechanisms have helped provide financial support to achieve and sustain universally available, reliable telecommunications service at affordable prices. These support mechanisms were established in large part during an era in which technological change occurred at a measured pace and limited competitive market conditions existed. The current telecommunications environment is very different. Today's environment is characterized by rapidly evolving technologies and accelerating competitive market characteristics.

Current subsidy/support mechanisms can be categorized as: a) those that are between companies providing telecommunications services, b) those within a company but between various services or customer groups, c) those that support certain end users/consumers, and d) others that indirectly affect the price of telephone services. Several of these subsidy/support mechanisms are explicit funding plans in which payments are made from one telecommunications industry group of companies to another. In other cases, the mechanisms are implicit payments from certain services providing contribution to others receiving support.

C. DESCRIPTION OF CURRENT SUBSIDY/SUPPORT MECHANISMS

1. UNIVERSAL SERVICE FUND (USF)

USF is an interstate support mechanism that provides assistance to local exchange telephone companies serving customers in areas in which the cost to provide telephone lines is relatively high. A telephone company is eligible to receive support payments from this fund if the telephone line costs for the facilities that connect customers to the switching office exceed 115 percent of the nationwide average cost of similar facilities for all telephone companies. Interexchange long distance service providers (e.g., AT&T, MCI, Sprint) serving at least 5% of the end users/consumers with presubscribed "1+" long distance service make support payments to this fund. The amount of support paid by each interexchange long distance service provider is based on the proportion of customers presubscribed to one company's "1+" long distance service versus other long distance companies.

2. LONG TERM SUPPORT (LTS)

This mechanism provides assistance to local exchange telephone companies, typically small telephone companies, serving customers in areas in which the cost to provide telephone lines is relatively high. The purpose of this mechanism is to facilitate the preservation of nationwide average prices for long distance service. Currently, a portion of the interstate cost of local telephone lines is recovered by local exchange telephone companies through Carrier Common Line (CCL) charges that are applied on a per minute basis. The long term support amount is equal to the difference in the total CCL charges that small local exchange telephone companies would have to charge to recover their costs and a CCL amount based on the weighted average price of telephone companies currently subject to price cap regulation. The receiving telephone companies determine the amount by aggregating their costs in a pool administered by the National Exchange Carriers Association (NECA). Local exchange telephone companies that no longer participate in the NECA common line pool, such as SWBT, are the source of funds for long term support. These telephone companies apply an additive to their own CCL price to recover the additional cost of this support.

3. CARRIER COMMON LINE (CCL)

Common lines are the communications connections between an end user's premises and a telephone company switch location. Currently, a portion of the cost of local telephone lines is recovered by local exchange telephone companies through charges to access service customers. These charges are called Carrier Common Line (CCL) charges and are applied on a per minute basis.

4. $25 SPECIAL ACCESS SURCHARGE

This surcharge is assessed to users of certain special types of exchange facilities, i.e., WATS and dedicated private lines, that use the local telephone company's network for connection to interstate or foreign telecommunications. Because these special types of lines do not connect through the network in the same way as normal local exchange telephone lines, Carrier Common Line (CCL) charges are not applied as would normally be the case. This surcharge is a surrogate for the CCL charges that would normally apply.

5. SOCIAL POLICY PRICING

Local exchange basic telephone services have as a general rule been priced at low levels by being financially supported by other services. To establish prices for local exchange telephone service, a total revenue requirement for a particular state is determined.

Recovery of this total revenue requirement from non-basic services is attempted first. The remaining revenue amount that cannot be generated by non-basic services is recovered from residually priced local exchange telephone service. The non-basic services that provide this financial support are switched access, intrastate toll, special access, private line, and optional services such as community optional area calling, custom calling features, and touch-tone. Another social policy pricing practice used to provide implicit support to certain service areas is price averaging. Price averaging involves establishment of the same price for services across large geographic areas, such as an entire state. Price averaging has been used to avoid the effect on prices of differences in costs between high cost and low cost areas.

6. LIFELINE

The lifeline program provides financial assistance to low-income subscribers qualified on the basis of a state established income test (means test). End user Common Line (EUCL) charges will be reduced by the FCC by 50 to 100 percent if intrastate monthly local exchange rates are reduced by an equivalent amount. Lifeline is funded by interexchange long distance companies on the same basis as the USF mechanism. That is, lifeline funding is based on the proportion of a long distance company's presubscribed "1+" customers relative to other providers.

7. LINKUP

The linkup program provides financial assistance to low-income subscribers by reducing the cost of installation charges required to initiate telephone service up to a maximum of $30. Recipients of linkup assistance are qualified on the basis of a state established income test (means test). Linkup is funded through direct charges to interexchange long distance companies on the same basis as the USF mechanism. Linkup funding is based on the proportion of a long distance company's presubscribed "1+" customers relative to other providers.

8. TELECOMMUNICATIONS RELAY SERVICE (TRS) FUND

This is a newly adopted shared funding mechanism that provides support for the interstate telecommunications relay services. These services provide communications capabilities to individuals with hearing and speech disabilities. All telecommunications companies that provide interstate services, which includes interexchange long distance companies, cellular telephone and paging companies, local exchange telephone companies, and others, will pay into this fund based on their relative proportion of overall interstate revenues.

9. CAPITAL RECOVERY/DEPRECIATION

Application of depreciation as an expense category is the means by which a local exchange telephone company recovers its investment in physical plant that is consumed in providing services. This physical plant includes switching equipment, electronic circuit equipment, cable facilities, buildings, telephone poles, underground conduit, motor vehicles and other physical property items. Depreciation rates and methods are prescribed by the FCC and applicable state commissions during "three-way" meetings in which representatives from the local telephone company, the FCC, and the state commissions meet to negotiate acceptable depreciation rates and methods. These rates and methods are regularly reviewed and revised, as necessary, on a three year represcription cycle. As part of the process, carriers submit detailed depreciation rate studies to support their estimates.

Historically, regulators have prescribed long service lives resulting in correspondingly low depreciation rates. Consequently, low depreciation rates contributed to keeping the price of telephone service low. In an era when there was little competition in the telecommunications industry and technological advances were moderately paced, the risks inherent in deferring capital recovery (i.e., prescribing lower depreciation rates) were minimal because the regulator could ensure the continuation of supporting pricing policies. However, since the current depreciation prescription process was established, the telecommunications industry has experienced considerable change. Competition has increased in the industry, resulting in a shortening of the useful lives of plant. Also, the increased pace of technological change has affected the useful economic life of certain plant items. Consequently, local telephone companies have a diminishing opportunity to recover their embedded investment which was placed in service under existing social contracts. Also, the existing capital recovery framework will limit local telephone companies' ability to compete in the future by limiting the companies ability to reduce its cost structure.

10. DIAL EQUIPMENT MINUTES (DEM) WEIGHTING

Small local exchange telephone companies with fewer than 50,000 access lines are allowed by the FCC to increase the allocation of their network switching costs that is recovered from their interstate access services. As a result, less switching costs are recovered directly from end users/consumers because their local exchange telephone service charges are lower than they would normally be. This special weighting factor allows up to a maximum of 85 percent of a qualifying telephone company's total switching equipment costs to be recovered by interstate access services.

CERTIFICATE OF SERVICE

I, Kelly Brickey, hereby certify that the foregoing "Comments of Southwestern Bell Telephone Company" in Docket No. RM8388, has been served this 16th day of December, 1993 to the Parties of Record.

Kelly Brickey

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